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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In The Matter of	)	
	)	
Implementation of the	)	CC Docket No. 96-128
Pay Telephone Reclassification	)	
And Compensation Provisions of the	)	
Telecommunications Act of 1996	)	

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REPLY COMMENTS OF
LCI INTERNATIONAL TELECOM CORP.

LCI International Telecom Corp. ("LCI"),[1] by its attorneys, respectfully submits the following reply to the initial comments on the Court's second remand of payphone compensation to the Commission.[2]

I. PSP ATTEMPTS TO PROP-UP A LOCAL COIN APPROACH SHOULD BE REJECTED

Not surprisingly, the PSP comments downplay the two appellate reversals and suggest that the Commission need only provide a better explanation to support its excessive compensation rate.[3] The RBOC Coalition even goes so far as to make the remarkable claim that the D.C. Circuit "did not criticize" the Commission's approach.[4] Anyone who attended the oral argument, or anyone who reads the Court's opinion issued just one week later, knows how

1 LCI is a wholly owned subsidiary of Qwest Communications Corporation.

2 Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding, DA 98-1198 (rel. June 19, 1998) (*Public* Notice); *see* MCI *Telecommunications Corporation, et al. v. FCC*, slip op. (D.C. Cir. No. 97-1675 May 15, 1998) (*Payphone II*).

3 *See, e.g.,* RBOC Comments at 2-3; APCC Comments at 1-3.

4 RBOC Comments at i.

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wrong the RBOCs are. The Court was deeply troubled by the Commission's compensation rate – troubled by the logic of the approach, not merely its explanation.

The PSPs' now-rote recitations of the alleged virtues of a local coin rate approach do not justify futile attempts to prop-up the remanded compensation rate. The Commission has heard these arguments before – and has unsuccessfully relied upon them in part. More importantly, the Court has twice been presented with the full force of the PSPs' skillful advocacy in support of the approach, but twice has remanded the FCC's compensation decision. The PSPs' arguments fail because they gloss over or obfuscate the two key, but ultimately unsupportable, assumptions upon which the local coin approach is based: (1) the contention that competition for end user rates exists from payphones, and (2) the claim that the markets for local coin and for subscriber 800 and access code calls are similar.

A. The PSPs Do Not Show That There is End User Rate Competition

The RBOCs and APCC assume that the competition for payphone location contracts translates into competition to lower end user rates from payphones. They argue that because any provider may compete to win a location's business (that is, because the payphone business is "competitive"), end user rates reflect costs. But, as the Commission is well aware from its lengthy proceedings involving operator services from aggregator locations (including payphones), competition among providers does not guarantee competition for end user rates. Even APCC admits that the competition among payphone providers did not bring about low 0+ rates.[5] This competition is, of course, the same competition that APCC relies upon to set local coin rates. In the end, APCC and the RBOCs offer lots of theory that local rates will reflect

[5] APCC Comments at 6 n.7.

costs, but no empirical evidence that PSPs even attempt to compete for end users by establishing competitive coin rates.

Indeed, the PSPs are suprisingly untroubled by the contradiction between their claims that the local coin rate reflects costs, on the one hand, and their admission that coin rates are now almost uniformly $.35 across all locations and PSPs.[6] As LCI explained in its initial comments, if the local coin rate reflected costs, one would expect that the rate would vary from phone to phone, as geographic or provider-specific cost differences varied.[7] Although the PSPs readily acknowledge cost differences among payphone stations and locations,[8] they make no attempt to demonstrate that these differences translate into end user rate competition. Clearly, other factors are interfering with competition for end user local rates. Because there is no assurance deregulated local rates will reflect the cost of coin calls, a "market-based" surrogate using this rate must fail.

B. The PSPs Admit To Significant Differences in the Markets for Coin and Coinless Calls

Even if local coin rates reflected coin costs, use of that rate to set compensation for coinless calls (subscriber 800 and access code) is irrational because the markets are fundamentally different. Indeed, APCC's economists admit that the markets are "largely although not completely independent."[9] When two markets operate "largely" independently, one

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6 APCC Comments at 4-5 (citing the "relatively uniform prevalence" of a $.35 rate); RBOC Comments at 9 ("prevailing rate" is $.35 in 43 states; suggesting that regulators' pressures have kept rate lower in others).

7 LCI Comments at 5-6.

8 APCC Comments, Haring/Rohlfs Aff. at 7.

9 APCC Comments, Haring/Rohlfs Aff. at 8 (citing demand differences).

cannot serve as a surrogate for the other. Therefore, coinless compensation should not be based on the market for a local coin call – even if that market operated competitively.

The RBOCs acknowledge that there are differences between the two markets, but claim that those differences are calculable. In particular, despite having asserted only 13 pages earlier in its comments that cost-based regulation is "notoriously inaccurate and contentious," the RBOCs claim that the cost adjustments to a local coin rate are easily calculable.[10] The RBOCs cannot have it both ways. If cost calculations are "notoriously inaccurate" and suffer from the other defects asserted in the comments (RBOC Comments at 4-7), then the local coin approach also must fail. Payphone I made it clear that the Commission may not set compensation equal to the local coin rate; if it cannot calculate costs accurately, however, then no adjustment will survive review under the arbitrary and capricious standard. On the other hand, if the defects of cost-regulation can magically disappear to calculate a cost adjustment, then the Commission is just as capable of setting a cost-based rate in the first place. A cost-based approach also has the added advantage of not requiring the FCC to endorse market dynamics in the coin market or to compare and contrast coinless and coin markets.[11] Accordingly, as long as costs are "calculable," the Commission should do so, from the bottom up.

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[10] *Compare* RBOC Comments at 4 (cost regulation is "notoriously inaccurate and contentious") *with id.* at 17 ("the differential costs between the services are calculable").

[11] Apparently trying to downplay the Commission's error in ignoring reliable evidence of LEC PSPs' costs, the RBOCs claim their share of the payphone market is approximately 66%. RBOC Comments at 20 n.14 & Andersen Report at 10. Not only do the RBOCs' numbers misleadingly create the appearance of a downward trend by relying on different sources for its estimates of the total market (from PSPs with less than 2% market share), but the numbers are not consistent with their own claims for compensation. In the first quarter of 1998, the RBOC Coalition members claimed over 1.6 million compensable payphone ANIs, which exceeds 75 percent of the total claims LCI received.

II. OTHER SUGGESTED "MARKET SURROGATE" APPROACHES WOULD GROSSLY OVERCOMPENSATE PSPS

Implicitly conceding the weakness of relying on local coin rates, the PSPs suggest other (higher) alleged "market surrogates" could be used. These surrogates already have been rejected as inapposite comparisons by the Commission. Moreover, the surrogate that both APCC and the RBOCs claim is the "best" surrogate, 0+ rates, actually supports a compensation amount of approximately 12 cents, not the nearly $1 per call the PSPs seek.

A. O+ Commission Rates Do Not Approximate the Cost of Access Code and Coinless Calls

The list of converts to the 0+ surrogate has grown by one, with the RBOC Coalition now joining APCC in advocating compensation based upon 0+ rates. However, it is inappropriate to derive a compensation amount by focusing on the alleged value of a 0+ call to an OSP. An OSP's assessment of value will be based on a multitude of factors not present in access code or subscriber 800 calling. First, the Commission has long recognized that 0+ commissions are a form of marketing expense to OSPs.[12] They can, and in many cases do, substitute for OSP expenditures to advertise their services more broadly to the public.[13] Second, the default status itself is beneficial to the OSP, because the carrier gains access to customers that have not previously established a relationship with the carrier. Third, as the PSPs implicitly concede, an OSP's willingness to offer 0+ commissions depends in part upon the rate it expects it can charge

[12] *National Telephone Services, Inc.*, 8 FCC Rcd 654, 655 (1993).

[13] Indeed, as the Commission noted, the placard on the telephone can itself be advertising of the OSP's services. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd 20,541, at ¶ 69 (1996).

end users for those calls. These factors make the 0+ rate an inaccurate surrogate for the costs of subscriber 800 or access code calls.

Most importantly, even if the 0+ rate had any relevance, the PSPs misapply the analogy. If correctly applied, the 0+ commission levels claimed by the PSPs validates a cost-based compensation rate of below 15 cents per call. At the outset of this proceeding, APCC declared that, due to their inability to obtain fair compensation for access code and subscriber 800 calls, PSPs were "forced" to subsidize these calls with 0+ revenues.[14] In other words, PSPs demanded greater commissions from 0+ carriers, in order to compensate them for the lack of revenues received on the compensable calls at issue in this proceeding.[15] Accepting this premise as true, then the total revenues PSPs received from 0+ calls represented at least the amount PSPs needed to receive to recover their costs for 0+ calls, <u>and</u> for originating access code and subscriber 800 calls. Using the call counts APCC supplied in this proceeding, APCC's claimed average of AT&T 0+ commissions (62.5 cents) and accounting for the $6 per phone per month received under the prior compensation plan, PSPs received 11.9 cents for each of the calls "subsidized" by 0+ rates.[16] Accordingly, this measure supports the reasonableness of a cost-based rate between $.10 and $.15 per call.

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14 APCC July 1, 1996 Comments at 7-9.

15 The fact that a PSP could force an OSP to "subsidize" other types of calls merely underscores the market power inherent in the locational monopoly.

16 The calculation was made as follows: (24 (0+ calls/month) * $.625 (average AT&T commission) + $6 (access code compensation)) divided by 176 (total access code, subscriber 800 and 0+ calls/month). *See* APCC 1997 Remand Comments at Attachment 4. Even if the RBOC's estimate of $.90 to $1.33 per call commissions is used, the total per "subsidized" call is only 15.6 to 21.5 cents per call.

B. Other "Market Surrogates" are Grossly in Excess of Any Reasonable Measure of Coinless Origination Costs

For similar reasons, the Commission should summarily reject the other proposed surrogates offered by APCC. Neither 0- transfer rates nor sent-paid surcharges involve the same types of costs associated with originating access code or subscriber 800 traffic. In fact, both involve significant additional costs – such as live operator time (in the case of 0- calls) and coin signalling costs (for sent-paid calls) – that are not present with access code or subscriber 800 calls. Therefore, compensation based on these rates would grossly overcompensate PSPs for costs that manifestly are not incurred in originating access code or subscriber 800 calls.

CONCLUSION

For the foregoing reasons, and for the reasons stated in LCI's initial comments, the Commission should put the local coin approach to rest, once and for all. In its place, the Commission should establish a cost-based compensation amount using reliable data representative of the payphone industry as a whole. Alternatively, if the Commission wishes to set compensation based upon a market, it should adopt the caller pays approach as the best device to establish a true market for access code and subscriber 800 calling.

Respectfully submitted,

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